

STATE OF NEW YORK
DIVISION OF TAX APPEALS

In the Matter of the Petition	:	
of	:	
MARIE TODARO,	:	
OFFICER OF DELAWARE DRAPERY, INC.	:	
for Revision of a Determination or for Refund	:	
of Sales and Use Taxes under Articles 28 and 29	:	
of the Tax Law for the Period March 1, 1981	:	
through August 31, 1983.	:	
<hr/>		DETERMINATION
In the Matter of the Petition	:	
of	:	
DELAWARE DRAPERY, INC.	:	
for Revision of a Determination or for Refund	:	
of Sales and Use Taxes under Articles 28 and 29	:	
of the Tax Law for the Period March 1, 1981	:	
through August 31, 1983.	:	

Petitioner Marie Todaro, officer of Delaware Drapery, Inc., 69 Bidwell Parkway, Buffalo, New York 14209, filed a petition for revision of a determination or for refund of sales and use taxes under Articles 28 and 29 of the Tax Law for the period March 1, 1981 through August 31, 1983 (File No. 801709).

Petitioner Delaware Drapery, Inc., 1414 Delaware Avenue, Buffalo, New York 14209, filed a petition for revision of a determination or for refund of sales and use taxes under Articles 28 and 29 of the Tax Law for the period March 1, 1981 through August 31, 1983 (File No. 801710).

A consolidated hearing was commenced before Timothy J. Alston, Administrative Law Judge, at the offices of the Division of Tax Appeals, 462 Washington Street, Buffalo, New York, on March 2, 1989 at 9:15 A.M. and continued to conclusion on August 16, 1989 at 1:15 P.M., with all briefs to be submitted by December 8, 1989. Petitioners appeared by

Boreanaz, Baker & Humann (Harold J. Boreanaz, Esq., of counsel). The Division of Taxation appeared by William F. Collins, Esq. (Deborah J. Dwyer, Esq., of counsel).

ISSUE

Whether, as the result of a field audit, the Division of Taxation properly determined additional tax due.

FINDINGS OF FACT

On October 15, 1984, following an audit, the Division of Taxation issued a Notice of Determination and Demand for Payment of Sales and Use Taxes Due to petitioner Delaware Drapery, Inc. which assessed \$22,890.34 in tax due, plus penalty and interest, for the period March 1, 1981 through August 31, 1983.

On October 31, 1984, the Division issued a Notice of Determination and Demand for Payment of Sales and Use Taxes Due to petitioner Marie Todaro, officer of Delaware Drapery, Inc. This notice assessed identical amounts of tax, penalty and interest due with respect to the same periods as the October 15, 1984 notice issued to the corporation.

At hearing the Division withdrew its assessment of tax, penalty and interest against petitioner Marie Todaro with respect to the sales tax period March 1, 1981 through May 31, 1981.

Delaware Drapery, Inc., formed in or about 1974, was in the business of selling and installing custom-made draperies, rods and blinds. Marie Todaro, the corporation's sole shareholder, ran the business on a day-to-day basis. Mrs. Todaro was assisted in this business endeavor by her husband, Samuel Todaro. Mrs. Todaro conceded her status as a person required to collect tax on behalf of Delaware Drapery, Inc.

During the period at issue, the corporation's accountant was one Cyrus Trossman of the firm Trossman and Trossman. Martin E. Trossman, C.P.A., was Cyrus Trossman's partner. Cyrus Trossman prepared the corporation's Federal income tax returns during this period. He used records of the corporation's bank deposits to determine gross receipts for the corporation's Federal income tax returns.

From the record it cannot be determined precisely how the corporation's sales tax returns were prepared. The returns were signed by Mrs. Todaro. For each of the sales tax periods at issue, the corporation's sales tax returns listed the same sales figure for both gross sales and taxable sales. Petitioner reported \$249,622.00 in gross and taxable sales during the audit period.

In the summer of 1983, because of the failing health of both Mrs. Todaro and her husband, the entire Delaware Drapery, Inc. stock was sold by Mrs. Todaro to Priscilla Carcales and her husband. The effective date of this transfer of ownership was September 1, 1983. After this date, with the exception of some transitional help for about one month, Mrs. Todaro had no involvement with the business operations of Delaware Drapery, Inc. After this transitional period, certain business records and invoices for sales for the period at issue herein which had been maintained by petitioner were located at the Delaware Drapery premises. Also, for this same period, certain cancelled checks and bank statements were in the possession of the corporation's accountant, Cyrus Trossman. The corporation continued its same business to the present date.

Cyrus Trossman died in February 1984. The Division's auditor was unaware of Mr. Trossman's death until sometime after the issuance of the notices herein.

During the period at issue, the corporation recorded job orders on worksheets. At the time a customer placed an order, that job received a job number. The job number followed the job through the ordering of materials and, finally, to installation. These worksheets listed the customer's name, the job number, the date of the order, and the amount of the sale. The worksheets did not indicate whether sales tax was charged on a given sale or whether a sale was tax-exempt. An envelope bearing the job number was also assigned to the job. This envelope contained orders for materials to be used in connection with the job, any drawings submitted in connection with that job, etc.

Also during the period at issue, the corporation issued invoices only to customers that were billed upon completion of the job. Generally, such billed customers were commercial

customers. The corporation required residential customers (i.e. homeowners and renters) to pay a deposit upon placing an order and then to pay in full upon completion of the job. Such customers were not issued invoices. The invoices issued by the corporation to its billed customers did not bear the job number.

During the audit period, the corporation maintained an account at Marine Midland Bank and an account at M & T Bank. Corporate sales receipts were deposited, usually daily, into the M & T account. Petitioners used funds in this account to pay suppliers and to pay general operating expenses. Petitioners generally used the Marine Midland account to pay taxes and payroll. Cyrus Trossman was aware of the existence of the Marine Midland and M & T accounts.

The audit herein resulted from the Division's IRTF/STM Computer Tape Match program whereby reported gross receipts for Federal income tax purposes are compared with gross sales reported on sales tax returns. On audit, the Division's auditor first contacted Mrs. Carcales by telephone on June 28, 1984 and advised her of the audit and the periods in question. Mrs. Carcales advised the auditor of the change in ownership of the corporation on September 1, 1983. Mrs. Carcales further advised the auditor that she was not in possession of corporate records pertaining to periods before September 1, 1983 and directed the auditor to petitioner Marie Todaro, the previous owner, for the pre-September 1, 1983 corporate records. The auditor then telephoned Mrs. Todaro (also on June 28, 1984). The two had a conversation wherein the auditor advised Mrs. Todaro that an audit of Delaware Drapery, Inc. was to be conducted whereupon Mrs. Todaro advised the auditor that the corporation's records with respect to the period of her ownership were located at the office of Martin E. Trossman, C.P.A. The auditor then made three unsuccessful attempts to contact Mr. Trossman by telephone, and on the final attempt advised Mr. Trossman's office that he (the auditor) would be at the Delaware Drapery premises on July 12, 1984. Mr. Trossman appeared at the Delaware Drapery premises on July 12 and the auditor advised Mr. Trossman of the apparent disparity between the corporation's gross receipts per Federal income tax returns and gross sales reported on sales

tax returns in respect of the period October 1, 1981 through September 30, 1983. Mr. Trossman advised the auditor that bank deposit records were used to determine the corporation's gross receipts for Federal tax purposes. Mr. Trossman speculated that a loan to the corporation might account for a part of the difference and indicated to the auditor that he (Mr. Trossman) would attempt to document or reconcile this difference. The auditor did not request any specific records from Mr. Trossman.

The auditor was not contacted by Mr. Trossman in connection with Mr. Trossman's attempt to reconcile the difference between the corporation's reported gross receipts and reported gross sales. The auditor therefore commenced to compute the assessment herein based upon this difference. The corporation reported \$209,862.00 and \$241,297.00 in gross receipts on its Federal income tax returns for its fiscal years ended September 30, 1982 and September 30, 1983, respectively. It reported \$99,941.00 and \$95,578.00, respectively, in gross/taxable sales on its quarterly sales tax returns for these same periods.¹ The difference between gross receipts per Federal returns and gross sales per sales tax returns for this two-year period thus totaled \$255,640.00. The ratio of this difference to gross sales reported for the two-year period amounted to 1.31. The Division then applied this ratio to gross sales reported for each of the ten sales tax periods encompassed by the audit period herein to reach \$22,890.34 in tax due as set forth in the notices of determination.

Mrs. Carcales provided the auditor with copies of the corporation's Federal income tax returns and New York State franchise tax reports for the fiscal years ended September 30, 1982 and September 30, 1983.

¹The corporation's fiscal year did not correspond with the quarterly sales tax reporting periods, e.g., the quarter ended November 30, 1981 fell partly in fiscal year ended September 30, 1981 and partly in fiscal year ended September 30, 1982. In order to reconcile this overlap, the Division apportioned the gross sales reported for the November 30 quarter into the appropriate fiscal year. For example, the Division determined that two-thirds of gross sales reported in the November 30, 1981 quarter and one-third of the gross sales reported in the November 30, 1982 quarter fell in fiscal year ended September 30, 1982. The Division applied the same apportioning method with respect to fiscal year ended September 30, 1983.

The auditor did not make any written requests for books and records to either Mrs. Carcales, Mrs. Todaro or Mr. Trossman.

On its sales tax return for the quarter ended November 30, 1983, the corporation reported \$54,520.00 in gross sales and \$50,227.00 in taxable sales. On its sales tax return for the quarter ended February 28, 1984, the corporation reported \$41,177.00 in gross sales and \$38,151.00 in taxable sales.

CONCLUSIONS OF LAW

A. The retail sale of draperies, rods and blinds is taxable pursuant to Tax Law § 1105(a). The retail sale of the service of installing draperies, rods and blinds is taxable pursuant to Tax Law § 1105(c)(3). Section 1132(c) presumes that all receipts for, inter alia, "property or services of any type mentioned in [Tax Law § 1105(a) and (c)]...are subject to tax until the contrary is established, and the burden of proving that any receipt...is not taxable hereunder shall be upon the person required to collect tax...." Accordingly, all sales made by Delaware Drapery, Inc. were properly presumed taxable until proven otherwise.

B. With respect to the Division's audit methodology, the first area to be addressed is whether, under the facts and circumstances herein, the Division properly determined tax due based on percentages of error which were, in turn, developed from the difference between gross receipts as reported for Federal income tax purposes and the corporation's gross and taxable sales as reported on its sales tax returns. Contrary to the Division's assertion, the audit method employed was an indirect estimate of petitioners' sales tax liability. The methodology did not purport to calculate the exact amount of tax due for each sales tax period. Rather, the method presumed that petitioners' gross receipts for Federal purposes constituted taxable sales and, further, projected the difference between gross receipts and gross/taxable sales reported for a two-year period over a 30-month period. Moreover, the Division's assessment was not based upon any records purporting to document petitioners' sales. That the records upon which the Division based its estimate were the corporation's own income tax returns does not, as the Division contends, remove the methodology from scrutiny under the rule of

Chartair v. State Tax Commn. (65 AD2d 44, 411 NYS2d 41) and its progeny.

C. Tax Law § 1138(a) provides that where a sales tax return when filed is incorrect or insufficient, tax due shall be determined "from such information as may be available". The Division's use of an indirect audit method to determine tax due is proper where a taxpayer does not have the records necessary to verify taxable sales (Matter of Licata v. Chu, 64 NY2d 873, 487 NYS2d 552). Every person required to collect sales tax must maintain records sufficient to verify all transactions in a manner suitable to determine the correct amount of tax due (Tax Law § 1135[a]; 20 NYCRR 533.2[a]).

To determine the adequacy of a taxpayer's records the Division must first request (Matter of Christ Cella v. State Tax Commn. 102 AD2d 352, 477 NYS2d 858, 859) and thoroughly examine (Matter of King Crab Restaurant v. Chu, 134 AD2d 51, 522 NYS 978, 979-80) the taxpayer's books and records for the entire period of the proposed assessment (Matter of Adamides v. Chu, 134 AD2d 776, 521 NYS2d 826, 828, lv denied 71 NY2d 806). The request for records must be explicit and not "weak and casual" (Matter of Yel-Bom's Service Center, Inc., Tax Appeals Tribunal, May 10, 1990; Matter of Christ Cella v. State Tax Commn., supra). The failure of the taxpayer to cooperate with the Division and to make its records available upon such a Division request authorizes the Division to use an indirect audit methodology to estimate tax due (Matter of Continental Arms v. State Tax Commn. 72 NY2d 976, 534 NYS2d 362, 363).

D. Petitioners contend that the Division's contacts with Mrs. Todaro, Mrs. Carcales and Mr. Martin Trossman at best constituted "weak and casual" requests for records and that therefore the resort to the audit method employed herein was unjustified under the rule of Christ Cella (supra).

Petitioners' contention is rejected. The record herein indicates that the auditor first contacted Mrs. Carcales, the principal owner of Delaware Drapery, Inc. and was advised by Mrs. Carcales that she was not in possession of corporate records pertaining to the period in question. The auditor then contacted the previous owner of the business, Mrs. Todaro, and was

advised that all records pertaining to the period in question were in possession of Mr. Martin Trossman. Following three unanswered telephone calls, Mr. Trossman met with the auditor on the Delaware Drapery premises on July 12, 1983, while the auditor was conducting the audit. The auditor advised Mr. Trossman of the apparent disparity between the corporation's Federal income tax returns for the fiscal years ended September 30, 1982 and September 30, 1983 and the corporation's sales tax returns for the same period. Mr. Trossman speculated that a loan to the corporation might account for a part of the difference and indicated to the auditor that he (Mr. Trossman) would attempt to document the apparent disparity. Mr. Trossman made no further contact with the auditor.

With respect to the auditor's contact with Mrs. Carcales and Mrs. Todaro, it was certainly reasonable for the auditor to rely on their statements indicating that neither was in possession of Delaware Drapery records pertaining to the period in question. Each obviously was in a position to know whether or not they were in possession of the records in question. Moreover, although the lack of a written request for records may constitute a failure to follow field audit guidelines, the record herein is clear that both Mrs. Carcales and Mrs. Todaro advised the auditor that neither was in possession of records for the period in question. Thus, even if the auditor had made a written request for records, such a request would have had no effect on the audit herein, for it is reasonable to presume that both Mrs. Carcales and Mrs. Todaro would have again advised the auditor in a similar manner.

With respect to the auditor's contact with Mr. Trossman, although the auditor did not demand specific records, the record is clear that the auditor presented Mr. Trossman with the disparity between gross receipts and gross/taxable sales for the fiscal years ended September 30, 1982 and September 30, 1983. In response, Mr. Trossman indicated that he would attempt to reconcile or document the disparity. By his response, it is clear that Mr. Trossman understood that the auditor was seeking specific records to explain the apparent disparity. Given Mr. Trossman's response thereto, and apparent understanding thereof, the auditor's contact with Mr. Trossman constituted an explicit request for records for the period encompassed by the

returns (i.e., 10/1/81 - 9/30/83) that was more than "weak and casual" (Matter of Christ Cella v. State Tax Commn., supra), and the failure to respond to that request authorized the Division's use of the indirect audit method employed herein (see Matter of Continental Arms v. State Tax Commn., supra).

E. It should be noted that even if one were to conclude that the Division's auditor failed to make a request for records sufficient to meet the standard of Christ Cella and Yel-Bom's Service Center (supra), the Division would nonetheless be authorized to use the audit method employed herein, for the evidence adduced at hearing establishes that petitioners' sales tax records were in fact inadequate (Matter of Cafe Europa, Tax Appeals Tribunal, July 13, 1989) and the Division is not required to examine insufficient records (Matter of Korba v. State Tax Commn. 84 AD2d 655, 444 NYS2d 312, 314, lv denied 56 NY2d 502, 450 NYS2d 1023). Even if one were to accept as fact all of petitioners' contentions regarding the corporation's recordkeeping system, such records were nonetheless clearly inadequate for the purpose of verifying taxable sales (see Matter of Licata v. Chu 64 NY2d 873, 487 NYS2d 552). According to petitioners' own evidence, the daily worksheets were the only record maintained of the corporation's sales. Petitioners did not issue invoices for each sale. Petitioners did not maintain comprehensive ledgers or journals. Thus, even accepting petitioners' contentions regarding recordkeeping as fact, petitioners maintained no records which could be used to test the accuracy of the daily worksheets. Moreover, petitioners did not rely upon the daily worksheets in the preparation of any tax returns. The Federal returns were prepared using bank deposits and (although not found as a fact herein) petitioners contended that the sales tax returns were prepared using bank deposits and a list of exempt sales. Inasmuch as the sufficiency of petitioners' recordkeeping may be determined from the record herein, the use of an indirect method to determine tax due is justified (see Matter of Cafe Europa, supra; cf. Matter of King Crab Restaurant v. Chu, supra).

F. With respect to the period March 1, 1981 through September 30, 1981, the record is clear that the Division did not request any records of petitioners. In the auditor's contact with

Mrs. Carcales he was referred to Mrs. Todaro in respect of pre-September 1, 1983 records.

Mrs. Todaro, in turn, referred the auditor to Mr. Martin Trossman. In his contact with Mr. Trossman, the auditor discussed only the disparity between gross receipts and gross/taxable sales in respect of the fiscal years ended September 30, 1982 and September 30, 1983. There is no evidence in the record that the auditor and Mr. Trossman ever discussed the period March 1, 1981 through September 30, 1981. Since the Division made no request for records in respect of the period March 1, 1981 through September 30, 1981, the assessment in respect of this period must be cancelled (Matter of Christ Cella, Inc. v. State Tax Commn., 102 AD2d 352, 477 NYS2d 858, 859; Matter of Adamides v. Chu, 134 AD2d 776, 521 NYS2d 826, lv denied 71 NY2d 806, 530 NYS2d 109).

G. Having concluded that petitioners failed to produce records upon Division request in respect of the October 1, 1981 through August 31, 1983 period, the Division had a duty to determine sales tax due from such information as was available (Tax Law § 1138[a][1]). Under such circumstances the Division is required to select an audit method reasonably calculated to reflect the tax due (Matter of Grant Co. v. Joseph, 2 NY2d 196, 204, 159 NYS2d 150, 157, cert denied 355 US 869). Where the Division selects such an audit method a presumption of correctness attaches to the assessment (Matter of Cousins Service Station, Tax Appeals Tribunal, August 11, 1988) and petitioner bears the burden of proving error (Matter of Scarpulla v. State Tax Commn., 120 AD2d 842, 502 NYS2d 113).

H. Petitioners have failed to prove error in either the audit method or result. With respect to the methodology, it was manifestly reasonable to assess tax based upon reported gross receipts for Federal income tax purposes, for Tax Law § 1132(c) presumes the taxability of all receipts. Moreover, the corporation's sales tax returns indicated that 100% of its sales were taxable.

Petitioners attacked the audit result on two fronts. First, petitioners contended that the corporation's Federal income tax returns overstated the corporation's gross receipts. Specifically, petitioners contended that among the bank deposits included on the income tax

returns as gross receipts were loans to the corporation by Marie Todaro and also transfers of funds from one corporate account to another. These contentions are rejected. The evidence presented fails to establish that any loans were made by Marie Todaro to the corporation. There is no evidence of indebtedness, such as a promissory note or bookkeeping entry, to establish the existence of such loans. There is also no evidence to show that such amounts were deposited in a corporate account. Moreover, even if such loans were made, the evidence presented fails to establish that Cyrus Trossman included such loan amounts in his computation of gross receipts for Federal income tax purposes. Mr. Todaro's testimony at hearing indicated that Cyrus Trossman was aware of the (purported) \$7,500.00 loan. In fact, according to Mr. Todaro, Mr. Trossman advised that Mrs. Todaro make the purported loan. Thus, to accept petitioner's contention with respect to the \$7,500.00 "loan", one must conclude that although Mr. Trossman was aware that the \$7,500.00 was a loan, he included this amount in the corporation's gross receipts anyway.

As to the transfers of funds between accounts, there is insufficient evidence in the record to conclude that any specific transfers were made. The evidence presented establishes only that certain deposits were made into a Marine Midland account. There is insufficient evidence to show that the amounts in question were transferred from one corporate account to another, or even that all such deposits were made to the same account. Moreover, even if such transfers were made, the record does not show that such amounts were included in gross receipts. The record does indicate that Cyrus Trossman was aware of the existence of both accounts. To conclude, as petitioners argue, that corporate gross receipts included transfers of funds between corporate accounts, one must conclude that petitioners and Mr. Trossman failed to take steps to assure that the gross receipts figures were not overstated, even though each was aware that two corporate accounts existed, that tax returns were prepared using deposit records, and that transfers of funds between accounts may have occurred. The evidence presented is insufficient to support such a conclusion.

Petitioners' second line of attack sought to establish that the corporation's gross receipts

included sales that were exempt from tax. This contention is also rejected. The evidence introduced consists of worksheets drawn up by Mrs. Todaro following a review of purportedly existing records located at the store. With the exception of a single invoice,² none of the purportedly existing records were introduced into evidence. Moreover, notwithstanding the fact that, according to petitioners' evidence, some \$77,671.00 in exempt sales occurred during the audit period, not a single resale certificate or exempt organization certificate was introduced into evidence even though, according to petitioners, such exemption documents were maintained by the corporation and were on the premises when the business was sold. Petitioners contended that all such documentation had been lost. No evidence was offered to explain the purported loss of the exemption documentation. Also, as noted above, petitioners claimed some \$77,671.00 in exempt sales. This amounts to about 31.1% of the corporation's reported gross sales during the audit period. Yet, on the corporate sales tax returns, petitioners reported identical amounts under gross sales and taxable sales for each of the reporting periods at issue, thereby indicating that the corporation had no exempt sales. Additionally, it is noted that for the two quarters subsequent to the sale of the business on September 1, 1983, sales tax returns filed indicate nontaxable sales amounting to about 7.9% and 7.3% of gross sales, respectively, for these periods. Thus while it appears probable that petitioners had some amount of exempt sales, they have failed to establish the existence of specific exempt sales.

I. The petitions of Marie Todaro, officer of Delaware Drapery, Inc., and Delaware Drapery, Inc. are granted to the extent indicated in Conclusions of Law "F" and "H", footnote 2, and Finding of Fact "3"; the Division is directed to adjust the notices of determination and demands for payment of sales and use taxes due herein, dated October 15, 1984 and October 31,

²This invoice, dated December 3, 1981, indicates a sale of \$1,936.00 to Millard Fillmore Hospital. By credible testimony in connection with this sale petitioners established an exempt sale in the amount of \$1,936.00, and the Division is directed to adjust the notices of determination herein accordingly.

1984, in accordance therewith; and, except as so granted, the petitions are in all other respects denied.

DATED: Troy, New York

ADMINISTRATIVE LAW JUDGE